EXHIBIT #3
DATE 3-22-11
HB 608

Testimony – In Opposition
House Bill 608
Introduced by Rep. Wayne Stahl

House State Administration
March 22, 2011
Teachers' Retirement System

HB 608 – Annuity Benefit Plan for New Hires

HB 608 proposes to close all current Defined Benefit (DB) plans to new hires and require all public employees initially hired after July 1, 2012, to become members of an Annuity Benefit Program administrated by the Department of Administration with a contract, or contracts, with one more or companies to provide a fixed annuity. In other words, this will require that all new hires after July 1, 2012, participate in a Defined Contribution (DC) plan.

The first problem with HB 608 is that it diverts a portion of the actuarially required contributions TRS currently receives and removes, over time, a significant and increasing amount of the salary base upon which the contributions to the retirement system are calculated. Under current law, each employer participating in TRS is required to contribute 7.47% of the salary of all members who participate in the System if they are a K-12, county, or community college employer, and 9.85% if they are a State or University System employer. In addition, TRS receives 2.38% of all salaries paid to members who are employed by a K-12, county, or community college employer, and 0.11% of all member's salaries from the State General Fund. Under HB 608, none of these amounts would be received by TRS on the salaries of any employees initially hired after July 1, 2012, who would otherwise be reported to TRS; thus reducing actuarial funding necessary to amortize the Unfunded Actuarial Accrued Liability (UAAL) and potentially resulting in a violation of the Montana Constitution.

> ***Montana Constitution, Article VIII, Section 15. Public retirement system assets.***
>
> *(1) Public retirement systems shall be funded on an actuarially sound basis. Public retirement system assets, including income and* ***actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated*** *and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses.*
>
> *(2) The governing boards of public retirement systems shall administer the system, including actuarial determinations, as fiduciaries of system participants and their beneficiaries.*

Fiscal Note: The TRS is currently underfunded to the tune of around $1.5 billion as of July 1, 2010. Depending on future investment returns, that number could be between $1.7 and $1.9 billion by July 1, 2012, when HB 608 takes effect. Current contribution rates are already insufficient to amortize the unfunded liability and either need to be increased or additional funding must be provided from other sources. HB 608 does just the opposite, and reduces anticipated revenues required to amortize the UAAL. On the other hand, schools and other employers participating in TRS will see a small reduction in their costs because the HB 608 employer rate (7.0%) is less than the current TRS employer rate (7.47% for schools).

	Total	Percent of total contribution applied toward the Normal Cost	Percent of total contribution applied toward the UAAL
Employee	7.15%	7.15%	NA
Employer	7.47%	2.59%	4.88%
State	2.49%	NA	2.49%
Total	**17.11%**	**9.74%**	**7.37%**

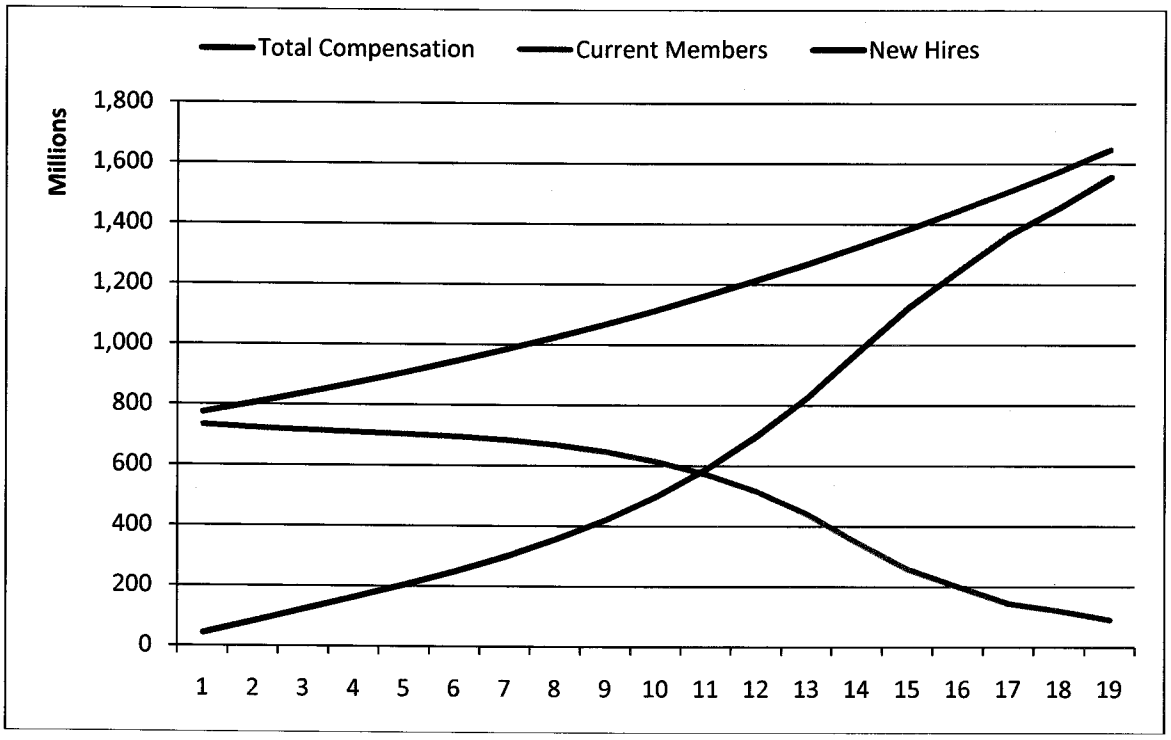
As you can see from the following table, the reduction in funding to the TRS that would result under HB 608 is significant and will continue to get much larger over time. HB 608 will further exacerbate the funding problem future legislatures must deal with.

	FY 2012	FY 2013	FY2014	FY 2015
TRS Loss	$0.00	$3,100,600	$6,031,100	$8,949,200
General Fund Savings	$0.00	$1,108,471	$2,429,157	$3,199,399
Schools Savings	$0.00	$ 146,814	$ 285,577	$ 423,750

Actuarial Methods: In the short term, closing the TRS plan to new entrants will require a change in the actuarial methods used to finance the Unfunded Actuarial Accrued Liabilities (UAAL). Since new hires will not be joining the current TRS plan, the payroll base of the plan will begin to decline immediately, so less employer funding will be available to pay down the UAAL. Therefore, based on the Governmental Accounting Standards Board requirements under Statements 25 and 27, the payroll growth assumption used in financing the UAAL will change from a 4.5% increasing payroll methodology, to a 5% declining payroll methodology. In addition, the amortization period over which the UAAL must be paid would be reduced to match the remaining working lifetime of current active members, approximately 11 years. Therefore, since the payroll base used to fund the System's UAAL and the amortization period are both reduced, the Annual Required Contributions (ARC) to amortization the UAAL as a percent of payroll will increase 23.84% effective July 1, 2012, from 7.37% to 31.21%.

Annual Required Contribution: If the legislature were to act this session to actuarially fund TRS, based on market values, a contribution rate increase of 5.17% would be required. However, with the passage of HB 608, the ARC required to actuarially fund TRS would increase by 23.84%. Not contributing the ARC could lead to a reduction in the State's credit rating, indirectly; thus increasing the cost to issue bonds, i.e., an indirect tax increase.

Required Actuarial Funding Increase	FY 2012	FY 2013	FY2014	FY 2015
Currently TRS - 5.17%	$ 40,030,500	$ 41,307,100	$ 43,259,100	$ 45,012,000
HB 608 – 23.84%	NA	$172,350,500	$170,529,000	$168,950,000



The second problem is that HB 608 creates a Defined Contribution plan for new hires when it is well documented that DB plans provide the best bang for the retirement buck. In fact, a report completed in August 2008 by the National Institute on Retirement Security (see attached fact sheet) found that the economic efficiencies of DB plans make them nearly half the cost of DC plans. Considering just the normal cost of the current DB plan (not including the unfunded liability), HB 608 is almost one and one half times as costly as the current TRS DB plan – HB 608 will cost 14% of salary, while the normal cost for the current TRS plan is only 9.74%, of which only 2.59% is paid by employers. (In other words, when we pay off the UAAL in the future, current contribution rates could be reduced to 9.74%.) The normal cost of the current TRS is far less expensive than what is proposed in HB 608, and the unfunded liabilities of the current TRS will still have to be funded even if new hires are moved to the Annuity Benefit Plan under HB 608.

Finally, HB 608 does not define the structure for creating an Annuity Benefit Plan, but leaves that up to the Department of Administration, presumably with the assistance of a consultant, to approve the *rights and benefits to be provided, the relationship of these rights and benefits to the amount of contributions to be made, and the suitability of these rights and benefits to the needs of the participants*. In addition, the Department is required to create an advisory board, which shall serve as the fiduciary for the program. Yet there are no requirements or qualifications for the members of this advisory board, or even any direction as to the size of the board or its representation. What will be the fiduciary responsibility of these board members if one of the companies under contract with the Department of Administration goes bankrupt and participants lose part or all of their annuity account?

FACT Sheet

NATIONAL INSTITUTE ON
Retirement Security
Reliable Research. Sensible Solutions.

A Better Bang for the Buck
The Economic Efficiencies of Defined Benefit Pension Plans

Overview

The National Institute on Retirement Security has released a new report, "A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans." The report presents an original analysis on the efficiencies of defined benefit pension (DB) plans, and the costs of DB plans as compared to 401(k)-type individual defined contribution (DC) plans.

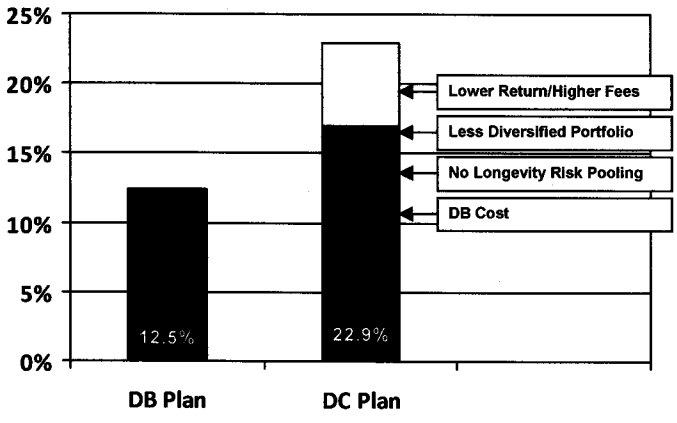
The report's analysis and findings serve as a myth buster with respect to the costs of defined benefit pension plans. Specifically, the embedded **economic efficiencies of DB plans make them nearly half the cost of DC plans, or a 46 percent cost savings.**

Policy and decision makers can utilize these findings to make informed decisions about retirement security issues and to evaluate claims that DC plans save money. The report concludes that DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints facing corporate and government retirement plan sponsors.

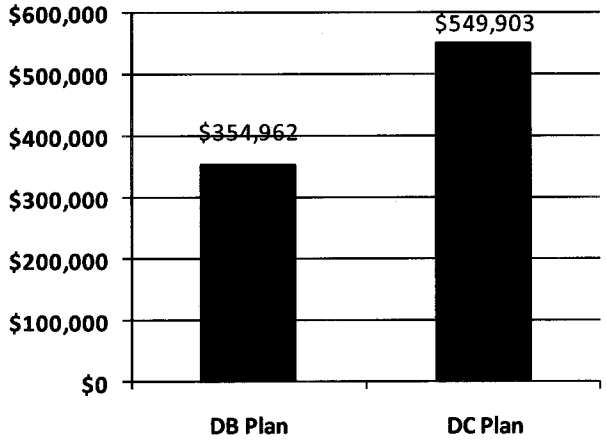
Methodology

The model makes an "apples to apples" calculation of the actual dollar contributions required for a DB and DC plan to achieve the same target retirement benefit. The target retirement benefit in the model is $26,684. Together with Social Security benefits, this retirement benefit allows a retiree to replace 83% of pre-retirement income, which meets generally accepted standards of retirement income adequacy.

Cost of DB and DC Plan as % of Payroll



Required Assets per Employee at Age 62



August 2008
www.nirsonline.org

Key Findings

The DB plan provides the best bang for the retirement buck. Under the model, the DB plan provides the same retirement income at nearly **half the cost - 46 % less** than individual 401(k)-type DC accounts.

Under the DB plan, contributions of 12.5% of payroll each year are required to fund the target retirement benefit. The DB plan will need to have $355,000 set aside for each participant by the time the worker turns 62. In contrast, the DC plan requires contributions of 22.9% of payroll each year. The less-efficient DC plan will need to have $550,000 set aside for each participant in the plan by the time the worker turns 62. In other words, the DB plan can provide the same benefit at a cost that is 46% lower than the DC plan. The **DB plan can do more with less providing the same benefit for nearly $200,000 less per participant.**

Economic Efficiencies Are Embedded in DB Plans

DB plans have certain embedded characteristics that drive their economic efficiencies:

1. **DB Plans Avoid "Over-Saving."** We won't all live to be ninety-five or one hundred. But in an individual plan, many of us will want to save enough to last until very old age to avoid the risk of running out of money. However, a DB plan only has to save for the AVERAGE life expectancy, which is much lower and which actuaries can calculate with a high degree of accuracy. By saving for a realistic average life expectancy, the DB plan realizes **a 15% cost savings** over the DC plan. In technical terms, this is called "longevity risk pooling."

2. **DB Plans Stay Forever Young.** Individuals age. Therefore, those in individual retirement plans must adjust their asset allocation to ensure sufficient cash is on hand to last throughout retirement. Most financial advisors counsel downshifting from higher risk/higher return investments to lower risk/lower return investments as they get older. This protects individuals from the risk of a stock market crash, but progressively reduces the investment returns that can be earned in retirement piggybanks. However, a DB plan exists across generations and therefore can always maintain the most optimal asset allocation. There isn't a need to be overly weighted in lower return/risk bonds or cash. This results in **a 5% cost savings** over the DC plan.

3. **DB Plans Achieve Higher Investment Returns.** The higher returns of DB plans as compared to individual accounts can be attributed a combination of professional asset management and lower fees. A retirement plan that earns greater investment returns will require less money in contributions. Even seemingly small differences in annual returns compound over time. In our model, a 1% difference in annual investment returns results in **a 26% cost savings** over a career, as compared to the DC plan.

Summary

"A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans," makes it clear that the embedded economic efficiencies of DB plans enable them to deliver the **same benefit at nearly half the cost of DC plans, or a 46 percent cost savings**. While the efficiencies of DB plans are well documented, this report is important in terms of quantifying the magnitude of those efficiencies.

The report's findings also serve as a myth buster to conventional wisdom with respect to the fiscal efficiencies and costs of DB pension plans. In fact, **DB plans are the most fiscally efficient means of providing a modest but stable retirement income that cannot be outlived**. DC plans are important to the retirement security equation, but they were not designed to stand on their own.

Policy and decision makers can utilize this data to make informed decisions about retirement security issues and to evaluate claims that DC plans save money. The report concludes that DB plans should remain a centerpiece of retirement income policy and practice, especially in light of current fiscal and economic constraints facing corporate and government retirement plan sponsors.